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No. OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1997

KEY BANK NATIONAL ASSOCIATION
f/k/a KEY BANK OF NEW YORK,

Petitioner,

vs.

RONALD P. MILHAM, BENEDETTA MILHAM
and ANDREA E. CELLI,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether an oversecured creditor of a Chapter 13 Debtor is entitled to be paid its contract rate of interest after confirmation of the Debtor's Chapter 13 Plan where the collateral is personal property such as a motor vehicle?

LIST OF PARTIES

The parties to the proceeding below are:

(1) Key Bank National Association, f/k/a Key Bank of New York, Creditor;

(2) Ronald P. Milham, Debtor;

(3) Benedetta Milham, Debtor;

(4) Andrea E. Celli, Esq., Chapter 13 Trustee.

STATEMENT PURSUANT TO RULE 29.6

KeyCorp is the parent company of Petitioner, KeyBank National Association. The following are nonwholly owned subsidiaries of KeyBank National Association:

Leasetec Corporation
Juniper Hill, Inc.
Compaq Capital (Hong Kong) Limited
Leasetec Australia Pty. Limited
Compaq Capital Europe, LLC
Compaq Capital A/P, LLC

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The Petitioner Key Bank National Association, f/k/a Key Bank of New York ("Key Bank") respectfully prays that a writ of certiorari issue to review the decision of the United States Court of Appeals for the Second Circuit decided on April 10, 1998. The decision is annexed hereto as Appendix "A". The decision of the Court of Appeals affirmed a decision of the Bankruptcy Appellate Panel for the United States Court of Appeals for the Second Circuit, dated July 3, 1997, which affirmed the Bankruptcy Court's confirmation of the Debtors' Plan, paying the outstanding balance at 8.5% per annum interest instead of the 9.5% contract rate of interest.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit, rendered on April 10, 1998, is set forth as Appendix "A".

The majority opinion of the Bankruptcy Appellate Panel for the Court of Appeals for the Second Circuit, decided on July 3, 1997, is reported at 211 B.R. 116 (Bankr. 2d Cir. 1997). That decision is set forth as Appendix "B". The decision of Hon. Michael J. Kaplan, United States Bankruptcy Judge, concurring in part and dissenting in part to the majority opinion is set forth as Appendix "C".

The Decision of the Bankruptcy Court for the Northern District of New York, dated August 22, 1996, is not reported. It was made orally and a transcript of the hearing is set forth as Appendix "D".

STATEMENT OF JURISDICTION

The order of the Court of Appeals for the Second Circuit was entered on April 10, 1998. This Petition for Certiorari is filed within ninety (90) days of April 10, 1998. The Court's jurisdiction to review the case rests upon 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 506(b):

> To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C. § 1322(b)(2):

> Subject to subsections (a) and (c) of this section, the plan may modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

11 U.S.C. § 1325(a)(5):

> Except as provided in subsection (b), the court shall confirm a plan if with respect to each allowed secured claim provided for by the Plan:
>
> > (A) the holder of such claim has accepted the plan;
> >
> > (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder.

STATEMENT OF THE CASE

The debtors Ronald and Bendetta Milham filed a petition for bankruptcy under Chapter 13 of the Code on April 24, 1996. Key Bank of New York is an oversecured creditor of the debtors. Debtors were indebted to Key Bank under a retail installment contract secured by a 1991 Lincoln Town Car. Debtors owe $3,163.07 on the contract which has an interest rate of 9.5%. The vehicle which secures the loan has a NADA average value of $11,962.50, but the debtors valued the vehicle at $8,713.00. The debtors had over $150,000 of unsecured credit card debt.

Debtors proposed payment to the creditor of $3,000 plus 8.5% interest. Key Bank objected, asserting that as an oversecured creditor it was entitled to the amount owed plus the contract rate of interest, and sought its contract rate of 9.5% (*See* copy of Objection at Pages 3-8 in the Appendix submitted herewith). At the confirmation hearing, the only issue was the appropriate rate of interest (*See* copy of Transcript of Hearing at Pages 9-16 in Appendix "D). Both debtor and the Trustee argued that the *In re: Dingley*, 189 B.R. 264 (Bankr. N.D.N.Y. 1995) decision required a lower interest rate than the contract rate proposed by the creditor.

The Bankruptcy Court confirmed the Chapter 13 Plan at the cramdown rate of 8.5%. Key Bank appealed to the Bankruptcy Appellate Panel ("BAP") which affirmed the Bankruptcy Court with a partial dissent by Judge Kaplan. The Court of Appeals for the Second Circuit affirmed.

REASONS FOR GRANTING THE WRIT

I.

THE DECISION BY THE COURT OF APPEALS FOR THE SECOND CIRCUIT CONFLICTS WITH THE DECISION BY THE COURT OF APPEALS FOR THE FIFTH CIRCUIT AND THERE IS NEED FOR UNIFORMITY ON THIS ISSUE.

Interpretation and construction of the Bankruptcy Laws should be uniform for debtors regardless of their geographic location. In consumer cases, a lender should not be forced to give disparate treatment to its customers based solely on the location of their bankruptcy cases.

The decision of the Second Circuit Court of Appeals at issue herein conflicts with a ruling of the Fifth Circuit Court of Appeals. The Fifth Circuit construed § 1325(a)(5)(B)(ii) of the Bankruptcy Code to provide the oversecured creditor with a rebuttable presumption that the pre-petition contract rate of interest applies following confirmation of a Chapter 13 Plan. *Smithwick v. Green Tree Financial Servicing Corp.*, 121 F.3d 211 (5th Cir. 1997), *cert. denied*, April 20, 1998, 1998 U.S. LEXIS 2552.

The Fifth Circuit relied on the rationale adopted by the Third Circuit Court of Appeals *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 65 (3d Cir. 1993) and decisions

in accord from the Fourth (*See United Carolina Bank v. Hall*, 993 F.2d 1126, 1130-1131 (4th Cir. 1993), Sixth (*See Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427, 431 (6th Cir. 1982)) and Tenth Circuits (*See In re: Hardzog*, 901 F.2d 858, 860 (10th Cir. 1990) (a Chapter 12 case). The Fifth Circuit, in a decision by Judge Edith Jones, specifically criticized (*Smithwick, supra* at 214) the reasoning adopted by the Second Circuit in a prior Chapter 13 case involving an undersecured creditor (*In re: Valente*, 105 F.3d 55, 63-64 (2d Cir. 1997)) and followed Judge Easterbrook's reasoning in *Koopmans v. Farm Credit Services of Mid-America*, 102 F.3d 874, 876 (7th Cir. 1996), interpreting an analogous statute in a Chapter 12 case.

Concededly, many of these cited cases deal with the undersecured creditor. But the Second Circuit in the case at issue followed its *In re: Valente* decision, even though here Key Bank is substantially oversecured. Clearly, there is lack of uniformity and the Second Circuit's decision and rationale is contrary to the holdings of many other Circuits.

Furthermore, this Court refused the debtor's application for certiorari this past April from the Fifth Circuit's decision in *Smithwick v. Green Tree Financial Servicing Corp.*, 121 F.3d 211 (5th Cir. 1997), *cert. denied*, __ U.S. __, (U.S. Sup. Ct., No. 97-1333, 4/20/98, 1998 U.S. LEXIS 2552). Secured creditors in the Fifth Circuit, and other Circuits as described above, therefore, receive more in Chapter 13 cases than secured creditors in New York. It is therefore respectfully submitted that this Court should grant the writ of certiorari to promote uniformity in bankruptcy matters and to reconcile the contrary interpretations adopted by the Second and Fifth Circuits. The *Smithwick* holding is the same as that proposed by Bankruptcy Judge Kaplan in his partial dissent in the Bankruptcy Appellate Panel's decision below (*See* Appendix "C"). The Second Circuit's decision does not mention either *Smithwick* or Judge Kaplan's dissenting opinion at the Bankruptcy Appellate Panel.

The need for uniformity in this area has become more pressing due to the high volume of consumer bankruptcies and the changing financial condition of Chapter 13 debtors. In the past, it was rare for a Chapter 13 debtor to have any equity in their motor vehicle. Now, however, many Chapter 13 debtors file because of excessive credit card debt. The Milhams are a good example of this new trend. They had equity in their home and equity in their motor vehicle, but had over $150,000 in credit card debt with joint annual income of between $50,000 and $60,000 per year. According to the Administration Office of the United States Courts, over 400,000 Chapter 13 cases were filed in the 12 month period ending March 31, 1998. The issue of post-confirmation interest rate to oversecured creditors on motor vehicles and other items of personal property may effect thousands of cases each year.

The question is one of statutory construction and therefore can only be finally resolved by this Court. It is therefore respectfully submitted that this Court should grant certiorari to resolve the conflict between the Circuits.

II.

THIS CASE REPRESENTS AN APPROPRIATE VEHICLE FOR THE COURT TO RESOLVE A RECURRING QUESTION OF STATUTORY CONSTRUCTION OF THE EFFECT OF 11 U.S.C. § 506(b) DURING AND AFTER CONFIRMATION OF A BANKRUPTCY CASE.

In discerning the meaning and effect of the bankruptcy statutes, courts should look first to the plain language of the Code. *Rake v. Wade*, 508 U.S. 464, 471 (1993). This Court has already given guidance on some of the statutes which are involved in the decision before this Court on this appeal. For

example, this Court has ruled that 11 U.S.C. § 506 applies in Chapter 13 cases. *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993). Section 506(b) provides holders of oversecured claims with an unqualified right to post-petition interest, regardless of whether the agreement giving rise to the claim provides for interest. *United States v. Ron Pair Enterprises*, 489 U.S. 235, 241 (1989). A debtor who seeks to cure mortgage arrearages must pay post-confirmation interest on the arrearages. *Rake v. Wade*, *supra*, 508 U.S. at 465, 66. And most recently, the valuation of a vehicle for the purpose of quantifying a Chapter 13 debtor's obligation to the lien holder uses the replacement value in the vehicle that would not be received when the vehicle was liquidated. *Associated Commercial Corp. v. Rash*, __ U.S. __, 117 S. Ct. 1879 (1997).

Against this backdrop, this Court is now asked to determine the rate of interest due an oversecured creditor following confirmation of the debtor's Plan where the debtor keeps using the motor vehicle which is the collateral. Specifically, the Court must decide the effect of 11 U.S.C. § 506(b), which entitles an oversecured creditor to post-petition interest post confirmation. The lower courts found that § 1322(b)(2), which allows the debtor to modify the rights of holders of secured claims in motor vehicles, and § 1325(a)(5)(B), which allows the debtor to confirm a Plan over the objection of the creditor provided the creditor retains the lien and receives further payments, cuts off the effect of § 506(b) at confirmation. In other words, confirmation ends the reach of 11 U.S.C. § 506(b) for the oversecured lender in motor vehicles.

This issue was one of first impression in the Court of Appeals for the Second Circuit. Generally, consumer debtors in bankruptcy do not have equity in their vehicles. Accordingly, most of the Circuit Court of Appeals cases dealing with 11 U.S.C. § 1325(a)(5)(B) deal with the undersecured creditor

(*See, e.g., General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 66 (3d Cir. 1993); *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993). The Second Circuit had previously ruled that for the undersecured creditor, a Chapter 13 debtor may confirm a Plan providing interest at less than the contract rate. *In re: Valente*, 105 F.3d 55 (2d Cir. 1997).

In the case on appeal, Judge Littlefield allowed confirmation over Key Bank's objection of the contract rate of interest even though Key Bank was oversecured (The Milhams owed Key Bank $3,163.07 and their Lincoln Town Car was worth at least twice more than was owed). It is respectfully submitted that this ruling is in error and that the oversecured creditor is entitled to its contract rate of interest post confirmation.

Under the 1938 Bankruptcy Act, a secured creditor of a bankrupt had three possibilities: (1) to prove his claim as an unsecured claim and surrender his security; or (2) to prove his claim as a secured claim and give the bankrupt credit for the value of the security; or (3) not to prove at all and rely solely on the security. *In re: Hospital Nuestra Senora de Guadalupe, Inc.*, 20 B.R. 1021 (Bankr. D. P.R. 1982). A fully secured creditor was not entitled to share in the distribution of his bankrupt creditor's estate. 3 *Collier on Bankruptcy*, ¶57.07 (3.3), p. 181 (14 ed. 1992). Thus, under the old Bankruptcy Act, a debtor could not avoid paying a contract rate of interest to the creditor up to the value of the collateral.

When the new Bankruptcy Code of 1978 was enacted, the legislative history clearly stated that the purpose of 11 U.S.C. § 506(b) was to codify existing law (*See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 356 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 68 (1978). It is submitted that this Court has already indicated that it construes § 506(b) to be what it was meant to be, *i.e.* a continuation of the treatment afforded

oversecured creditors under the prior Bankruptcy Act. *See Rake v. Wade*, 508 U.S. 464. Therefore, the decision below should be reversed and Key Bank awarded its contract rate of interest up to the value of its collateral.

It is further submitted that this result is consistent with the specific statutory language of the new Bankruptcy Code. As written, § 1325(a)(5)(B)(ii) protects the "allowed amount of [the oversecured creditor's] *claim.*" (Emphasis added). A claim is defined in the Code to be a right to payment even if unmatured. 11 U.S.C. § 105(5)(A). Thus, the statute allows for unmatured interest to be included in the *claim* being protected.

"The objective of § 1325(a)(5)(B)(ii) is to put the creditor in the same economic position that it would have been had it received the value of its allowed claim immediately." *In re: Valente*, 105 F.3d at 63. While that may be an appropriate standard for the undersecured creditor who is not entitled to post-petition interest, it is submitted that this is not appropriate for the oversecured creditor who does not receive its collateral. And this Court has expressly rejected the concept of treating the allowed *claim* as if the secured creditor received its collateral at confirmation. *Associated Commercial Corp. v. Rash*, __ U.S. at __, 117 S. Ct. 1879, 1885 (1997). Absent this discredited rationale for the purposes of § 1325(a)(5)(B)(ii), there is no justification to limit the scope of 11 U.S.C. § 506(b) to pre-confirmation interest.

In *Rake v. Wade*, *supra*, this Court ruled that an oversecured creditor on a home mortgage is entitled to interest on arrearages under both 11 U.S.C. § 506(b) and § 1325(a)(5). There, the debtor specifically argued that § 1322(b)(5) of the Code operates to the exclusion of § 506(b). *Id.* at 470. This Court expressly rejected this construction. In fact, the Court noted that

> Under the unqualified terms of § 506(b), therefore, respondent is entitled to pre-confirmation interest on these arrearages. Where the statutory language is clear, our "sole function . . ." is to enforce it according to its terms.

Id. at 471 (citations omitted).

The debtor then argued that § 1325(a)(5)(B)(ii) also applies to claims that were modified under § 1322(b)(2), and since they are not modifying the claim, the Section did not require post-confirmation interest. *Id* at 471. This Court also rejected this argument and found that interest was due post confirmation also. *Id.* at 473.

The Court was not presented with the issue of what interest rate to apply. *Id.* at 472, n. 8. If Code § 1325 does not overcome § 1322, and § 1322 does not overcome § 506(b), how can §1325 overcome § 506(b)? In other words, § 506(b)'s allowance of interest at the contract rate up to the value of the collateral should continue post confirmation.

When Congress subsequently enacted § 1322(3) to overrule portions of *Rake v. Wade*, it stated, "It is the Committee's intention that a cure pursuant to a plan should operate to put the debtor in the same position as if default had never occurred." 140 Cong. Rec. H. 10, 770 (October 4, 1994)). If the goal is to pretend that the default never happened, then it seems fair to follow the contract rate set forth in the underlying agreement between the parties. Otherwise, the debtor gets a windfall. It is submitted that using *Rake v. Wade* to justify short-changing an oversecured creditor on its contract rate of interest is not warranted.

Allowing the debtor to cram down the interest rate to oversecured creditors gives the debtor a windfall. The debtor

will have more available cash each month, either for payment to unsecured creditors, or for his own use. And, if the monthly payment is the same but the lien is paid off sooner than under the original contract, the debtor will therefore have more equity in the vehicle for trade-in or other purposes. Since most Chapter 13 cases are dependent upon the debtor using the vehicle for work and/or commuting, by giving the debtor a more favorable interest rate, the Bankruptcy Court is in effect forcing the oversecured creditor to subsidize the debtor and the other creditors by receiving less.

This result clearly was unacceptable to dissenting Judge Kaplan on the BAP panel. He believed that the objective of § 1325(a)(5)(B) was to prevent either the debtor or creditor from getting a windfall. He would therefore use the contract rate post confirmation unless market rates had substantially dropped. This approach had been expressly adopted by the Western District of Oklahoma under the reasoning that "bankruptcy promises honest but unfortunate debtors a fresh start, not a head start." *In re: Smith*, 192 B.R. 563, 568 (Bankr. W.D. Ok. 1996).

This Court has acknowledged that where the debtor retains the property, the creditor is exposed to double risk. The debtor may again default and the property may deteriorate from extended use. *Associated Commercial Corp. v. Rash*, __ U.S. at __, 117 S. Ct. at 1885. Where, as here, a secured creditor has properly controlled its credit risk by establishing adequate collateral value protection, it should not be exposed to a third risk, *i.e.* that the rate of interest will also be lowered post confirmation.

The BAP majority was apparently influenced by Congress' failure to include the phrase "contract rate of interest" when the 1984 amendments were made to the Bankruptcy Code. This

Court gave no weight to the legislative history of § 506(a) in *Rash*, (*See* __ U.S. at __, 117 S. Ct. at 1886, n.4), and, it is submitted, should follow the same logic here.

The 1984 amendments were prompted by the need to resolve the jurisdictional issues raised by the United States Supreme Court's decision of *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). (*See Analysis of Proposed Amendment to the Bankruptcy Act of 1978, Collier on Bankruptcy*, 15th Ed., Book E, App. Pt. 6, pp. 175-181 (1993)). Senator Hatch in his floor statement on the Bankruptcy Court and Federal Judgeship Act of 1984 described the more than thirty (30) amendments affecting consumer finance issues as needed "to ensure that a 'fresh start' does not become a 'head start.' " *Id.* at App. pt. 6, p. 172. The floor statements are silent as to the reasons why "contract rate of interest" was not added to 11 U.S.C. § 1325 as part of the 1984 amendment.

It is therefore submitted that the legislative history is not clear on the issue of post-confirmation interest rates for oversecured creditors. Because § 1325(a)(5)(B)(ii) applies to both the unsecured creditor and the oversecured creditor, it is submitted that the failure to include a requirement for contract rate of interest does not reflect Congressional purpose as to oversecured creditors, and is not helpful in determining whether § 1322(a)(5)(B)(ii) overcomes § 506(b) or vice versa.

As stated above, Congress added § 1322(e) to overturn a portion of the *Rake v. Wade* holding dealing with cure of pre-petition defaults. But Congress did not address that portion of *Rake v. Wade* that holds post-confirmation interest was due on pre-petition arrearages because the creditor was oversecured. It therefore could be argued that the failure of Congress to make any other changes means that Congress approves the Court's holding that § 506(b) overcomes § 1322(a)(5)(B)(ii) post

confirmation. Accordingly, it is submitted, the BAP's reliance on legislative history is unpersuasive. Furthermore, because § 506(b) was meant to codify existing law, there should have been an express statement that 11 U.S.C. § 1325(a)(5)(B)(ii) was meant to overturn existing law for oversecured Chapter 13 creditors if Congress so intended. There being no such legislative background, the argument that Congress wants the result reached by the courts below should not prevail.

The BAP also identified several Chapter 13 cases in which oversecured creditors were given non-contract rates post confirmation. One of those cases was overruled by the Fifth Circuit. (*See Green Tree Financial Servicing v. Smithwick*, 202 B.R. 420 (Bankr. S.D. Tx. 1996), *rev'd*, 121 F.3d 211 (5th Cir. 1997), *cert. denied*, __ U.S. __, 4/20/98, 1998 U.S. LEXIS 2552.) There is widespread confusion among and between the Bankruptcy Court on this point (*Compare In re: Wilsmeyer*, 171 B.R. 61 (Bankr. E.D. Mo. 1994) *with In re: Foertsch*, 167 B.R. 555 (Bankr. D. N.D. 1994) (Chapter 12) *and Ford Motor Credit Co. v. Johnston (In re: Johnston)*, 44 B.R. 667 (Bankr. W.D. Mo. 1994)).

It is submitted that the decision of Chief Justice Barry S. Schermer to the contrary (*In re: Wilsmeyer*, *supra*) reads more into *Rake v. Wade* than is justified. In that case, this Court was not asked to rule on the interest rate. It gave the oversecured creditor everything the creditor sought, so much so that Congress subsequently amended the Bankruptcy Code to overrule a part of this decision.

Furthermore, the decision of the Second Circuit may have an adverse impact on the rate of interest awarded oversecured creditors during the pendency of a Chapter 11 case, *(See In re: Liberty Warehouse Partnership*, __ B.R.__, (Bankr. S.D.N.Y., No. 96-B-43704 (Garrity J., 5/18/98), 1998 Bankr. LEXIS

594), because the Second Circuit interpreted this Court's rulings in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), and *Rake v. Wade*, *supra* to allow the Bankruptcy Court Judge to disregard the contract rate of interest during the pendency of the case (*See* pp. 4-5 of the Second Circuit's decision at Appendix "A"). There is need for clarity in the impact of 11 U.S.C. § 506(b) on the calculation of pending interest (*i.e.* while the case is pending) and post-confirmation interest due the oversecured creditor. This case gives the Court an opportunity to resolve a recurring question of statutory construction of the effect of 11 U.S.C. § 506(b) during and after confirmation of a bankruptcy case.

It is respectfully submitted that there is no clear decision on this issue, and no controlling precedent. Key Bank is asking this Court to issue a clear statement on the calculation of post-confirmation interest due to the oversecured creditor in Chapter 13 where collateral is personal property such as a motor vehicle.

CONCLUSION

Can a Chapter 13 debtor with substantial equity in his Lincoln Town Car cram down the interest rate due the oversecured lender secured by the vehicle post confirmation of the Chapter 13 Plan? The lower Courts have said yes. Appellant submits that this result forces it to subsidize the debtor and the unsecured creditors. This result is not equitable and contrary to 11 U.S.C. § 506(b). Further, the Second Circuit decision is at odds with holdings of other Circuits and creates disparate treatment for creditors based solely on the debtor's location at the time the bankruptcy petition is filed. The need for uniformity and the volume of Chapter 13 cases which are affected by 11 U.S.C. § 506(b) warrant this Court granting certiorari in this matter.

Collateral value is the only way a secured creditor can protect its bargain with its borrower where the borrower files in bankruptcy. It is submitted that the Bankruptcy Code expressly protects the bargain of an oversecured creditor by allowing payment in full of its *claim* up to the value of the collateral. Since *claims* include unmatured interest, it is submitted that an oversecured creditor is entitled to its contract rate of interest post confirmation. The Second Circuit's decision leaves the oversecured creditor in the same position as the undersecured creditor. It is submitted that this is erroneous as a matter of law and should be reversed.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DECIDED APRIL 19, 1998

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 1336 — August Term, 1998

(Argued: March 20, 1998 Decided: April 10, 1998)

Docket No. 97-5056

RONALD P. MILHAM and BENEDETTA MILHAM,

Debtors.

KEY BANK NATIONAL ASSOCIATION f/k/a KEY BANK OF NEW YORK,

Creditor-Appellant,

-against-

RONALD P. MILHAM and BENEDETTA MILHAM,

Debtors-Appellees,

ANDREA E. CELLI,

Trustee-Appellee

Appendix A

Before: JACOBS, LEVAL, and GIBSON,* *Circuit Judges*

Appeal from a decision of the Second Circuit Bankruptcy Appeal Panel (Lifland, *B.J.*) which affirms the final order of the United States Bankruptcy Court for the Northern District of New York (Littlefield, *B.J.*) confirming the debtors' Chapter 13 plan.

Affirmed.

* * *

PER CURIAM:

The question presented on this appeal, which is one of first impression in this Circuit, is whether an oversecured creditor is entitled to be paid its contract rate of interest post-confirmation even if the payment of that rate of interest will enable the creditor to receive more than the present value of its claim as of the effective date of the plan. For the reasons that follow, we answer this question in the negative.

BACKGROUND

Ronald and Benedetta Milham filed a petition under Chapter 13 of the Bankruptcy Code on April 24, 1996. They were indebted to Key Bank under a retail installment contract secured by a 1991 Lincoln Town Car. The Milhams owed $3,163.07 on the contract, which has an interest rate of 9.5%. The collateral has a National

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* Hon. John R. Gibson, of the United States Court of Appeals for the Eighth Circuit, sitting by designation.

Automobile Dealers Association value of $11,962.50.[1] Key Bank is therefore an oversecured creditor: the value of the asset securing its payment exceeds the amount of the debt owed to it.

The plan proposed by the Milhams contemplated payment of $3,000 plus 8.5% interest per annum on the Key Bank loan. Key Bank objected, arguing that as an oversecured creditor it is entitled to the entire amount owed plus the 9.5% per annum contract rate of interest. The Bankruptcy Court confirmed the plan at the 8.5% rate, and Key Bank appealed to the Second Circuit Bankruptcy Appellate Panel on the limited question of the applicable rate of interest post-confirmation. The panel affirmed the confirmation in an opinion by Judge Lifland, with a partial dissent by Judge Kaplan. This appeal followed.

DISCUSSION

"In a bankruptcy case, interest is the tail of the dog, but it is a long tail and it wags a lot." Dean Pawlowic, Entitlement to Interest Under the Bankruptcy Code, 12 Bankr. Dev. J. 149, 150 (1995). Directly or by implication, the Bankruptcy Code provides for three categories of interest: (1) interest accrued prior to the filing of the bankruptcy petition (prepetition interest); (2) interest accrued after the filing of a petition but prior to the effective date of a reorganization plan (pendency interest); and (3) interest to accrue under the terms of a reorganization plan (plan interest). *Id.* at 151. Prepetition interest is generally allowable to the extent and at the rate permitted under the applicable nonbankruptcy law, including the law of contracts. *Id.* Thus, for amounts accrued

1. According to the Milhams, the car has a value of $8,713.00. In any event, the Milhams do not dispute that the value of the collateral substantially exceeds the balance due to the creditor.

prior to the Milhams' filing, it is undisputed that Key Bank is entitled to interest at the contract rate.

Pendency interest presents a trickier question. In general, the Bankruptcy Code does not provide for pendency interest, because the filing of a bankruptcy petition usually stops interest costs from running. Section 506(b), however, provides an exception for oversecured creditors:

> To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs or charges provided for under the agreement under which such claim arose.

11 U.S.C. § 506(b) (1993). In this passage, Key Bank places heavy weight on the phrase "to the extent"; essentially, Key Bank argues that this provision guarantees it interest at the contract rate, even after confirmation, until the equity cushion is exhausted (that is, until the value of the collateral no longer exceeds the creditor's claim). Key Bank's position is problematic, for several reasons.

First, as the panel in the present case correctly noted, section 506(b) does not say that the oversecured creditor collects pendency interest at the contractual rate. In *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241, 109 S. Ct. 1026, 1030 (1989), the Supreme Court held that the phrase "provided for under the agreement under which such claims arose" does not modify the phrase "interest on such claim." Unlike prepetition interest, pendency interest is not based upon contract. *See Rake*

v. Wade, 508 U.S. 464, 468, 113 S. Ct. 2187, 2190 (1993) ("[T]he right to postpetition interest under § 506(b) is unqualified and exists regardless of whether the agreement giving rise to the claim provides for interest.") (internal quotation marks omitted). The appropriate rate of pendency interest is therefore within the limited discretion of the court. *See In re DeMaggio*, 175 B.R. 144, 148 (Bankr. D.N.H. 1994). Most courts have awarded pendency interest at the contractual rate; but nevertheless, however widespread this practice may be, it does not reflect an entitlement to interest at the contractual rate.

Even if Key Bank were entitled to pendency interest at 9.5%, that rate would apply only to the period bounded by the petition on one side and on the other by confirmation of the plan, because pendency interest does not continue to run post-confirmation. "It is generally recognized that the interest allowed by § 506(b) will accrue until payment of the secured claim or until the effective date of the plan." *Rake*, 508 U.S. at 468, 113 S. Ct. at 2190 (citing 3 Collier on Bankruptcy ¶ 506.05, pp. 506-43 and n.5c (15th ed. 1993)).

On the date of confirmation, the allowed claim of an oversecured creditor is augmented by the inclusion of section 506(b) pendency interest. *See, e.g., Orix Credit Alliance, Inc. v. Delta Resources, Inc. (In re Delta Resources, Inc.)*, 54 F.3d 722, 729 (11th Cir.) ("[A]n oversecured creditor . . . is entitled to receive postpetition interest as part of its claim at the time of confirmation of a plan or reorganization . . . ."), *cert. denied*, 116 S. Ct. 488 (1995); *In re DeMaggio*, 175 B.R. at 150 ("[Section 506(b) determines the exact amount of the claim . . . ."); *In re Foertsch*, 167 B.R. 555, 560 (Bankr. D.N.D. 1994) ("[Section] 506(b) allows an oversecured creditor to enhance its claim by adding to it postpetition interest. . . .").

Section 506(b) thus defines the allowed claim of an oversecured creditor; treatment of that claim after confirmation is governed by Section 1325, which establishes the circumstances under which the court may confirm a Chapter 13 debtor's reorganization plan:

> (a) . . . the court shall confirm a plan if —
>
> > (5) with respect to each allowed secured claim provided for by the plan —
> >
> > (A) the holder of such claim has accepted the plan;
> >
> > (B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and
> >
> > (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
> >
> > (C) the debtor surrenders the property securing such claim to such holder; . . .

11 U.S.C. § 1325(a) (1993). Under this provision, the court can confirm a plan if one of three conditions is satisfied with respect to secured creditors (a category which, of course, includes oversecured creditors): the secured creditor accepts the plan; the debtor surrenders the property securing the claim to the creditor; or the debtor invokes the so-called "cram-down" power

of section 1325(a)(5)(B). The present case concerns the cram-down option, pursuant to which the debtor can keep the property over the objection of the creditor. The creditor then retains a lien securing the claim and the debtor must pay the creditor over the life of the plan (which under Chapter 13 is not to exceed five years) amounts totalling the present value of the allowed secured claim as of the effective date of the plan. *See Associates Commercial Corp. v. Rash*, __ U.S. __, 117 S. Ct. 1879, 1882-83 (1997).

Postconfirmation interest, or plan interest, is a function of the present value requirement of the cram-down provision. The Code does not define the term "present value" but legislative history describes the mechanical process of determining present value in a manner consistent with the use of the term by the economic and financial community. *See In re Snider Farms, Inc.*, 83 B.R. 977, 988-89 (Bankr. N.D. Ind. 1988) (noting that "present value" is a financial term and recounting legislative history of a related provision). Thus, a bankruptcy court confirming a Chapter 13 plan that invokes the cram-down option would undertake the following calculation: first, the court would determine the sum of the principal amount (including section 506(b) interest) that would be due if it were to be paid in total on the date of confirmation; next, the court would determine the schedule of installment payments to be made pursuant to the plan; finally, the court would impose interest at a rate equal to that necessary to recoup the value of the secured claim determined in the first step.

We have previously determined that interest under § 1325(a)(5)(B)(ii) "should be fixed at the rate on a United States Treasury instrument with a maturity equivalent to the repayment schedule under the debtor's reorganization plan." *In re Valenti*, 105 F.3d 55, 64 (2d Cir. 1997). However, "[b]ecause the rate on

a treasury bond is virtually risk-free, the § 1325(a)(5)(B)(ii) interest rate should also include a premium to reflect the risk to the creditor in receiving deferred payments under the reorganization plan." *Id.* The court below determined that in the Milhams' case, this equation resulted in an 8.5% postconfirmation interest rate.

Key Bank argues that it should receive a higher rate of interest post-confirmation than one that would assure it the present value of its claim as of the confirmation date for two reasons: (1) it is entitled to its contract rate of interest; and (2) the words "to the extent" in section 506(b) mean that it continues to receive contract interest even after confirmation up until the point at which the equity cushion in the Lincoln Town Car is exhausted.

As to the first point, Key Bank's repeated theme is that it should not be required to accept less than contract interest in the post-confirmation period because that is no more than its well-secured contract right. But Key Bank's allowed claim under section 506(b) includes both principal and interest. By seeking to apply the contract rate to both components, Key Bank in essence seeks to compound its interest. Were we to adopt its interpretation, Key Bank would receive substantially more than a stream of payments equal to the "present value" of its claim under section 1325; it would receive compound interest for which its contract does not provide. Moreover, section 1322(b)(2) of the Code expressly authorizes debtors to modify the rights of secured claim holders (other than holders of claims secured only by the debtor's principal residence). 11 U.S.C. § 1332(b)(2) (1993). As the Ninth Circuit has noted, "[t]he cramdown route necessarily involves a modification of the creditor's rights with regard to such factors as number of payments *and the rate of interest*." *Shearson Lehman Mortgage Corp. v. Laguna (In re Laguna)*, 944 F.2d 542, 544-45 (9th Cir. 1991) (emphasis added) (citation omitted), *cert. denied*, 503 U.S. 966 (1992).

As to the second point, we prefer an interpretation of section 506(b) that accommodates section 1325, and we believe one is readily available. "To the extent" means that pendency interest runs (often, although not necessarily, at the contract rate) until the time of confirmation *unless* the equity cushion is exhausted before that; this makes perfect sense because at the point preconfirmation that the equity cushion is exhausted, the creditor ceases to be *over*secured.

Accordingly, we hold that an oversecured creditor such as Key Bank is entitled to receive § 506(b) interest only until the confirmation date of the Chapter 13 reorganization plan. At that time, the accumulated pendency interest becomes a part of the allowed secured claim, and the plan must provide for payment of the present value of such allowed claim as of the effective date of the plan. Present value is achieved by the payment of interest at a rate calculated in accordance with our holding in *In re Valenti*. Because the postconfirmation rate in the confirmed plan at issue was so calculated, the bankruptcy court decision confirming the plan, and the decision of the Bankruptcy Appellate Panel affirming the confirmation, are affirmed.

CONCLUSION

The decision of the Bankruptcy Appellate Panel is affirmed.

APPENDIX B — DECISION OF THE UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE SECOND CIRCUIT FILED JULY 31, 1997

UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE SECOND CIRCUIT

Chapter 13

Case No. 96-11076

BAP No. 96-50031

In re:

MICHAEL PETER HARKO and MARGARET GRACE HARKO

Debtors

KEY BANK OF NEW YORK

Appellants

- against -

MICHAEL PETER HARKO and MARGARET GRACE HARKO

Appellees

ANDREA E. CELLI

Trustee

Appendix B

Chapter 13

Case No. 96-12157

BAP No. 96-50033

In re:

RONALD P. MILHAM and BENEDETTA MILHAM

Debtors

KEY BANK OF NEW YORK

Appellants

- against -

RONALD P. MILHAM and BENEDETTA MILHAM

Appellees

ANDREA E. CELLI

Trustee

Argued: May 2, 1997 Decided: July 31, 1997

Appendix B

Appeal from the United States Bankruptcy Court
for the Northern District of New York
Hon. Robert E. Littlefield, Jr., Bankruptcy Judge

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Before: BURTON R. LIFLAND C.J., MICHAEL J. KAPLAN and JOHN C. NINFO II, JJ.

BURTON R. LIFLAND, C.J.

Two appeals are before us. In neither are the relevant facts in dispute. Both concern the same issue of law, namely whether an oversecured creditor in a case under Chapter 13 of the

Appendix B —

Bankruptcy Code (the "Code"), 11 U.S.C. §§ 1301-1330, is entitled to its contractual rate of interest pursuant to § 506(b) of the Code post-confirmation. The appellant in both cases is Key Bank of New York ("Key Bank"). The Debtors-Appellees in the first appeal, Michael and Margaret Harko (the "Harkos"), owed Key Bank $3,599.31 under a retail installment contract (the "Harko Contract"), secured by a 1991 Ford Explorer, the average National Automobile Dealers Association (NADA) value of which was $13,300. The Debtors-Appellees in the second appeal, Ronald and Benedetta Milham (the "Milhams"), owed Key Bank $3,163.07 under a retail installment contract (the "Milham Contract"), secured by a 1991 Lincoln Town Car the value of which was $11,962.50, according to Key Bank and $8,713.00 according to the Milhams. In any event, in both cases Key Bank is oversecured. In their respective Chapter 13 plans, the Harkos proposed payment to Key Bank of $3,555.00 with no interest while the Milhams proposed payment to Key Bank of $3,000 plus interest at 8.5% per annum. The contractual rate of interest under the Harko Contract was 13.95% per annum and under the Milham Contract it was 9.5% per annum. Key Bank filed objections to the respective plans, claiming that it was entitled to the contractual rate of interest pursuant to § 506(b) of the Code post-confirmation on its oversecured claims. The bankruptcy court overruled such objections, holding that the oversecured claim holder is entitled to interest at the pre-petition contract rate under § 506(b) only up to the effective date of the Chapter 13 plan: the interest rate applicable post confirmation is that which provides the "present value" of the allowed secured claim. The court approved a 9% interest rate in the case of the Harkos and an 8.5% interest rate in the case of the Milhams.

Appendix B

In the Milham appeal, we have had the benefit of the briefs of Key Bank, of an *amicus curiae,* the New York State Credit Union League, Inc., of the Milhams and of the Chapter 13 Trustee, Andrea E. Celli. In the Harko appeal, we have the briefs of Key Bank and of Ms. Celli.

Standard of Review

The facts are undisputed and the issue is one purely of law. The standard of review, accordingly, is *de novo. Bellamy v. Federal Home Loan Mortgage Corp. (In re Bellamy),* 962 F.2d 176, 178 (2d Cir.1992).

Discussion

The starting point of our inquiry is a review of the statutory provisions in question and, in the first place, § 1325 of the Code which sets forth the circumstances under which the bankruptcy court may confirm a Chapter 13 debtor's reorganization plan. Section 1325 provides, in material part, that:

> (a) . . . the court shall confirm a plan if —
>
> . . .
>
> (5) with respect to each allowed secured claim provided for by the plan
>
> (A) the holder of such claim has accepted the plan;
>
> (B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and

> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
>
> (C) the debtor surrenders the property securing such claim to such holder; . . .

See 11 U.S.C. § 1325(a). Under this provision, a plan's proposed treatment of secured claims can be confirmed if one of three conditions is satisfied: the secured creditor accepts the plan; the debtor surrenders the property securing the claim to the creditor; or the debtor invokes the so called "cram-down" power. *See Associates Commercial Corporation v. Rash*, __U.S. __; 1997 WL 321231, *2 (1997). Under the cramdown option, the debtor is permitted to keep the property over the objection of the creditor; the creditor retains the lien securing the claim and the debtor is required to provide the creditor with payments, over the life of the plan, that will total the present value of the allowed secured claim. *See id.*

With regard to the determination of the "allowed amount of [the] claim," we look first to § 502 of the Code which deals with the allowance and disallowance of claims. Under this section, a claim may become allowed in any of three ways: first, a proof of claim is filed and no party objects; second, a claim is allowed by the court after an objection is filed; and third, a claim is estimated by the court under the provisions of § 502(c). *See 4* Collier on Bankruptcy § 502.01 (15th ed. rev. 1996). A claim may be disallowed under any of the subsections of § 502(b) or under § 502(d) and (e). *See id.* For present purposes we need only concern ourselves with § 502(b)(2), pursuant to which, as a general rule, interest on prepetition

claims stops accruing as of the date of the filing of the bankruptcy petition.[1]

With regard to secured claims, however, § 506 of the Code must also be considered. Section 506(a) deals generally with the determination of secured status. It does not govern the allowance of claims.[2] Section 506(b), on the other hand, does affect the quantum of the allowed secured claim and provides the exception to the general rule that interest stops accruing as of the filing of the bankruptcy petition. Section 506(b) provides:

> (b) To the extent that an allowed secured claim is secured by property the value of which, after any

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1. Section 502(b)(2) reads, in relevant part: "[I]f [an] objection to a claim is made, the court . . . shall allow such claim in such amount, except to the extent that . . . such claim is for unmatured interest[.]"

2. The first sentence of § 506(a) provides for the bifurcation of an undersecured claim into separate and independent secured claim and unsecured claim components. It provides in relevant part:

> An allowed claim of a creditor secured by a lien . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

The second sentence of § 506(a) provides guidelines for the valuation contemplated by the first sentence. It provides:

> Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

> recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C. § 506(b). Thus, § 506(b) provides that an oversecured creditor is ordinarily entitled to postpetition interest on his claim.[3] Such interest becomes part of the creditor's allowed claim. This is apparent from the legislative history which states, with respect to fees, costs and charges:

> Subsection (b) codifies current law by entitling a creditor with an oversecured claim to any reasonable fees, costs, or charges provided under the agreement under which the claim arose. These fees, costs, and charges *are secured claims* to the extent that the value of the collateral exceeds the amount of the underlying claim.

H. Rep. No. 95-595 at 356, 357 (1977); S. Rep. No. 95-989 at 68 (1978) (emphasis added). There is nothing in the language of § 506(b) to suggest that interest, as opposed to fees, costs and charges, should be treated any differently and the majority

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3. Following the Supreme Court's holding in *U.S. v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989) that the phrase "provided for under the agreement under which such claims arose" does not qualify "interest on such claim," it is clear that § 506(b) does not mandate that the rate of interest to which the oversecured creditor is entitled postpetition is the contractual rate. Such rate is in the discretion of the court. *See In re DeMaggio*, 175 B.R. 144, 148 (Bankr. D.N.H. 1994). However, courts habitually award contractual interest.

of courts have so held. *See, e.g., Orix Credit Alliance, Inc. v. Delta Resources, Inc. (In re Delta Resources, Inc.),* 54 F.3d 722, 729 (11th Cir.1995) ("[A]n oversecured creditor . . . is entitled to receive postpetition interest as part of its claim at the time of confirmation of a plan or reorganization. . . .")[4]; *In re DeMaggio,* 175 B.R. at 150 ("[S]ection 506(b) determines the exact amount of the claim. . . ."; *In re Foertsch,* 167 B.R. 555, 560 (Bankr. D.N.D. 1994) ("[S]ection 506(b) allows an oversecured creditor to enhance its claim by adding to it postpetition interest ...."); *Warehouse Home Furnishings Distributors, Inc. v. Gladdin (In re Gladdin),* 107 B.R. 803, 806 (Bankr. M.D. Ga. 1989) ("[P]ostpetition interest actually becomes part of the secured claim ...."); *In re Busone, 71* B.R. 201, 203 (Bankr. E.D.N.Y. 1987) ("Section 506(b) determines the exact amount of the allowed secured claim. . . ."); *In re Hugee,* 54 B.R. 676, 678-79 (Bankr. D.S.C. 1985) ("The creditor is entitled to receive the contract rate of interest until the effective date of the plan—at which time the accumulated interest becomes a part of the allowed secured claim."; *In re Corliss,* 43 B.R. 176, 178 (Bankr. D. Or. 1984) ("The language of § 506(b) suggests the inclusion of post-petition interest as part of the allowed secured claim ...."); *In re Webb,* 29 B.R. 280, 286 (Bankr. E.D.N.Y. 1983) ("[S]ection 506(b) incorporates contractual provisions to fix the total secured claim."); *In re Klein,* 10 B.R. 657, 661 (Bankr. E.D.N.Y. 1981) ("For purposes of fixing the value of a creditor's secured claim,

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4. *But cf. In re Smith,* 178 B.R. 946, 951 (Bankr. D. Vt. 1995) in which the court noted:

> [I]nterest accruing on a loan prepetition is part of the claim in bankruptcy. The Code, however, does not provide for postpetition interest as part of the claim; rather, in some circumstances, it provides for interest on the claim.

[s]ection 506(b) permits the secured claim to include . . . interest. . . ."). Indeed, the Supreme Court in *Rake v. Wade*, 508 U.S. 464 (1993) speaks of interest as "part of the oversecured claim under § 506(b)." *Id.* at 471. Thus, the "allowed amount" of the oversecured creditor's claim will include, for purposes of § 1325(a)(5)(B)(ii), a sum representing post-petition interest. The value of property to be distributed under a Chapter 13 plan to an oversecured creditor may not be less than this amount.[5]

In addition, it is now well settled that full payment under § 1325(a)(5)(B)(ii) includes a "present value" component. *See General Motors Acceptance Corp. v. Valenti (In re Valenti)*, 105 F.3d 55, 63 (2d Cir.1997).[6] As the Second Circuit stated in *In re Valenti*, in theory, a creditor who receives the "present value" of its allowed claim is placed in the same economic position that it would have been in had it received the value of its allowed claim on the date the reorganization plan was

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5. As Dean Pawlowic has pointed out:

> [F]rom a policy viewpoint, it would make sense to treat pendency interest as part of the secured claim for purposes of plan interest, because pendency interest is a substantive right granted under the Code which would be subject to dilution if payable on a preferred basis without a present value requirement.

Dean Pawlowic, *Entitlement to Interest under the Bankruptcy Code*, 12 Bankr. Dev. J. 149, 1712.

6. The method of valuation of collateral under § 506(a) adopted in *In re Valenti* has been criticized by the Supreme Court. *See Associates Commercial Corporation v. Rash*, __ *U.S.* __, 1997 WL 321231, 7 (1997). However, *Rash* does not address "present value interest," the subject of this decision.

confirmed, *see id.*, and in *In re Bellamy,* the Second Circuit held that to compensate the creditor for its inability to use the money owed it while payments under the plan were being made, "section 1325 requires market rate interest in addition to payments on the allowed secured claim itself." 962 F.2d at 185-86.

While Key Bank does not espouse such result, if, as Key Bank argues, § 506(b) interest continues to accrue postconfirmation, we would observe that it follows from our foregoing discussion that a sum for such unmatured interest would have to be calculated as part of the "allowed amount" of the claim and the secured creditor would be entitled to the present value of this enhanced sum with the result that the debtor would be obligated to pay present value interest on unmatured interest. *See In re Gladdin,* 107 B.R. at 806; *In re Corliss,* 43 B.R. at 178. Such a result would produce a windfall to oversecured creditors and be wholly at odds with the objective of § 1325(a)(5)(B)(ii), which is "to put the creditor in the same economic position that it would have been in had it received the value of its allowed claim immediately." *In re Valenti,* 105 F.3d at 63.

The *substitution* of a contract rate of interest for present value interest, on the other hand, would be inconsistent with the objective of § 1325(a)(5)(B)(ii) as stated in *In re Valenti* and the rejection by the *Valenti* court of the "forced loan" approach. The Second Circuit stated that "[t]he purpose [of § 1325(a)(5)(B)(ii)] is not to put the creditor in the same position that it would have been in had it arranged a 'new' loan" and cited with approval *In re Dingley,* 189 B.R. 264 (Bankr. N.D.N.Y. 1995) which noted that "courts favoring the coerced loan theory impermissibly recast present value 'so as to preserve

the present value of the loan' as opposed to the secured claim." *Id.* at 269 (quoting Zywicki, T., *Cramdown And The Code: Calculating Cramdown Interest Rates Under The Bankruptcy Code* 19 T. Marshall L. Rev. 241, 252 (Spring 1994)). See *In re Valenti,* 105 F.3d at 63-64. Similarly, the Second Circuit in *In re Valenti* cited with approval *In re Hudock* 124 B.R. 532, 534 (Bankr. N.D.Ill.1991) ("[T]he Bankruptcy Code protects the creditor's interest in the property, not the creditor's interest in the profit it had hoped to make on the loan."). Otherwise, the creditor will receive more than the present value of its allowed claim. 105 F.3d at 64 (citing *In re Cellular Info. Sys., Inc.,* 171 B.R. 926, 939 (Bankr. S.D.N.Y. 1994)).[7]

Of crucial importance, too, are the provisions of § 1322(b)(2) of the Code[8] Section 1322(b)(2) authorizes debtors to modify the rights of secured claim holders, though it proscribes modification of the rights of holders of claims secured only by the debtor's principal residence. The language of the

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7. As noted by a number of courts, during the legislative process leading to the Bankruptcy Amendments and Federal Judgeship Act of 1984, Congress specifically considered an amendment requiring the contract rate of interest to be paid under § 1325(a)(5)(B)(ii) and rejected it. H.R. 1085, 98th Cong., 1st Sess. § 19(2)(A) (1983); H.R. 1169, 98th Cong., 1st Sess. § 19(2)(A) (1983); H.R. 4786, 97th Cong., § 19(2)(A) (1981); *see also Green Tree Financial Servicing Corp. v. Smithwick,* 202 B.R. 420, 423 (S.D.Texas.1996); *In re Collins,* 167 B.R. 842, 845 n. 4 (Bankr. E.D. Tex. 1994); *Matter of Richards,* 106 B.R. 762, 765 (Bankr. M.D. Ga. 1989).

8. Section 1322(b) provides in relevant part:

(b) . . . the plan may —

. . .

(Cont'd)

section is plain and the legislative history indicates the exception to the general rule that the rights of holders of secured claims may be modified in a Chapter 13 plan to be a very narrow one limited only to the rights of the mortgagee of the debtor's principal residence, an exception crafted to satisfy the home mortgage lending industry.[9] 124 Cong. Rec. H11106, H11107-H11115 (Sept. 28, 1978). There is no such exception for oversecured creditors.

Thus, the Ninth Circuit in *Shearson Lehman Mortgage Corp. v. Laguna (In re Laguna),* 944 F.2d 542 (9th Cir.1991), cert. denied, 503 U.S. 966 (1992), considered that the oversecured creditor's right to postpetition interest is qualified by, and must be understood in the context of, the interplay that exists between §§ 1322(b) and 1325(a) with respect to modification and cure and stated that "[t]he cramdown route necessarily involves a modification of the creditor's rights with

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(Cont'd)

> (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; . . .

11 U.S.C. § 1322(b).

9. For a helpful summary of the legislative history of § 1322(b)(2), *see In re Bellamy,* 962 F.2d at 181 -2. The Second Circuit concluded:

> Quite obviously the final version of § 1322(b)(2) represented a compromise. The legislative history therefore indicates only that § 1322(b)(2) was designed to provide greater protection to home mortgage lenders than other secured creditors in the Chapter 13 context.

regard to such factors as number of payments and the rate of interest." *Id.* at 544-5. Similarly, in *In re Smith, 178* B.R. 946 (Bankr. D. Vt. 1995), addressing the rights of an oversecured creditor in Chapter 12, the court recognized the overriding nature of § 1322(b) thus:

> Use of the contract rate is claimed by its proponents to be the best way to determine the market rate because it is usually at arm's length and presumably reflects current interest rates, the current cost of money, and accounts for risk and costs. These arguments sink in the Bankruptcy Code waters because Courts do not award profit, administration costs, risk, industry transactional costs, costs of collection, and all those other myriad elements that go into a contract rate. Moreover, the Code authorizes a debtor to change its creditors' contract rights. §§ 1123(b)(1), 1222(b)(2), 1322(b)(2).

Id. at 953.

The dissent herein takes issue with *In re Smith's* conclusion that bankruptcy courts "do not award profit, administration costs, risk, industry transactional costs, costs of collection, and all those other myriad elements that go into a contract rate." However, the concept that profit is not an element of present value interest is not, as the dissent claims, without its authority. The Second Circuit in *In re Valenti,* 105 F.3d at 63, expressly rejected the Third Circuit's argument in *General Motors Corp. v. Jones,* 999 F.2d 63 (3d Cir.1993) that "it would be inappropriate to attempt to exclude consideration of "profit" from a determination of the § 1325 interest rate," *id.* at 69, instead approving *In re Dingley* and *In re Hudock,* as noted above.

In addition, the dissent, relying on *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), argues that it is only contract rights, not statutory rights such as the oversecured creditor's right to postpetition interest under § 506(b), that may be modified under § 1322(b)(2).[10] We believe that the distinction that the Supreme Court was drawing in *Nobelman* was not between contractual rights on the one hand and statutory rights on the other. It was between modification of the rights of the holders of secured claims on the one hand and modification of secured claims on the other.[11] We do not read *Nobelman* as limiting the rights referenced in § 1322(b)(2).

Finally, contrary to the dissent's view, we do not believe that our analysis of the relationship between §§ 1325(a)(5)(B)(ii) and 506(b) is in any way inconsistent with the provisions of § 1322(b)(5) and (e). The curing of defaults pursuant to § 1322(b)(5) is a right conceptually distinct from Chapter 13 cramdown. It permits the debtor to take advantage of a contract repayment period which is longer than the Chapter 13 extension period, which may not exceed five years under any circumstances. 8 Collier on Bankruptcy § 1322.09[1] (15th ed.

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10. We would have to agree, in the light of *Ron Pair* and *Rake v. Wade* that § 506(b) confers rights to interest which are not necessarily contractually based. See further n. 3, *supra*.

11. In the context of an undersecured home mortgage, Chapter 13 debtors argued that the protection afforded by the "other than" exception in § 1322(b)(2) applied only to the extent the mortgagee held a secured claim in the debtor's home and did not prohibit alteration of such mortgagee's rights as to the unsecured portion of its claim. The Supreme Court rejected the argument holding that the mortgagee's rights were not limited by the valuation of its secured claim. The term "claim" in the "other than" clause refers to the lienholders entire claim, both secured and unsecured portions and it is the mortgagee's rights with respect to the entire claim that may not be modified.

rev. 1996) *and see Matter of Chappell,* 984 F.2d 775, 780 (7th Cir. 1993). Thus, the debtor may "trade" its § 1322(b)(2) right to modify contractual obligations (if applicable) for an extended repayment schedule under § 1322(b)(5). With regard to § 1322(e), enacted to overrule *Rake v. Wade,* the introductory language, which specifically references §§ 506(b) and 1325(a)(5), makes clear that these sections have no applicability in a cure situation. Thus, again, cure under § 1322(e) is conceptually distinct from cramdown. The cure provisions allow the debtor to keep the original contract in place and bring it up to date: they do not proscribe, and are not inconsistent with, prospective modification under the plan.

For all these reasons, we would hold that an oversecured creditor is entitled to receive interest pursuant to § 506(b) only until the effective date of the relevant Chapter 13 plan. At that time, the accumulated interest becomes part of its allowed secured claim and the plan must provide for payment to it of at least the present value of such allowed claim. In so holding, we are in accord with the majority of courts which have considered the interplay of § 1325(a)(5)(B)(ii) and § 506(b), as a brief review will illustrate.[12]

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12. A minority of courts have characterized the relationship between § 506(b) and § 1325(a)(5)(B)(ii) in a different fashion. For example, in *Koopmans v. Farm Credit Services of Mid-America, ACA,* 102 F.3d 874 (7th Cir. 1996), the Court of Appeals for the Seventh Circuit addressed the applicable interest rate in the case of an oversecured loan in a Chapter 12 cramdown. Having stated that the creditor was oversecured and entitled to interest pursuant to § 506(b), the court then posed itself the question, "at what rate?" The court answered the question by reference to § 1225(a)(5)(B)(ii), holding that the secured creditor was entitled to the "indubitable equivalence" of its property interest "which means a stream of

(Cont'd)

For example, in *In re Klein*, the court explained the relationship between § 506(b) and § 1325(a)(5)(B)(ii) thus:

> For purposes of fixing the value of a creditor's secured claim, [s]ection 506(b) permits the secured claim to include reasonable interest together with any reasonable fees, costs or charges provided for in the security agreement when the value of the collateral exceeds the amount of the allowed secured claim.
>
> The discount rate, on the other hand, does not become part of the secured claim, but is instead incremental adjustments to the secured claim to compensate the creditor for depreciation of the collateral over the term of the plan.

In re Klein, 10 B.R. at 661 (citations omitted). *In re Webb* held that:

> [S]ection 1325(a)(5) requires that the secured creditor receive not less than the present value of his allowed claim. Section 506, on the other hand, fixes that allowed secured claim. Therefore, as of the

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(Cont'd)
payments including interest that adds up to the present value of its claim." *Id.* at 874. *In re Anderson*, 28 B.R. 628 (S.D.Ohio.1982) held that § 506(b) "is incorporated by reference into Section 1325(a)(1), so that the bankruptcy court may not confirm a plan which fails to provide interest for eligible creditors." Nevertheless, the court found that the appropriate post-confirmation interest rate under § 506(b) to be the rate prescribed by Ohio law rather than the interest rate specified by the mortgage in question. We cannot agree with these analyses. Further, in *dicta* in *In re Smith*, 4 B.R. 12 (Bankr. E.D.N.Y. 1980) the court appeared to suggest that an oversecured creditor could receive § 506(b) interest in addition to present value. *Id.* at 13. We disagree.

> confirmation date, section 506(b) incorporates contractual provisions to fix the total secured claim. Thereafter, the Court, independently of the contract, must fix an interest factor such that the total of such deferred payments is equivalent to the receipt of the total claim today. By this method the secured party's rights are not modified but protected.

In re Webb, 29 B.R. at 286 (citations omitted). In *In re Corliss*, the court analyzed the relationship between § 506(b) and § 1325(a)(5)(B)(ii) thus:

> As the value of the payments to be distributed under [§ 1325(a)(5)(B)(ii)] must at least equal the allowed amount of the creditor's claim one must first ask of what the "allowed amount of the claim" consists within the context of that subsection. The language of § 506(b) suggests the inclusion of post-petition interest as part of the allowed secured claim to the extent of the value of the collateral. This interest will accrue from the date the petition is filed until the effective date of the plan. The secured creditor cannot, of course, receive any contract interest which is unmatured as of the effective date of the plan. To determine otherwise would obligate the debtor to pay the discount rate on unmatured interest and lead to payment of two forms of interest simultaneously.

In re Corliss, 43 B.R. at 178. The court in *In re Hugee* held that:

> The creditor is entitled to receive the contract rate of interest until the effective date of the plan — at which

> time the accumulated interest becomes a part of the allowed secured claim. From that time forward the oversecured creditor is entitled to receive the discount rate.

In re Hugee, 54 B.R. 676. The court in *In re Busone* found § 1325(a)(5)(B)(ii) and § 506(b) to be "not in conflict, but complementary." *In re Busone*, *71* B.R. at 203. It reasoned that § 506(b) determines the exact amount of the allowed secured claim while § 1325(a)(5)(B)(ii) requires that the plan payments return the present value of that figure to the creditor. *See id.* In *In re Gladdin*, the court considered the interplay of § 506(b) and § 1325(a)(5)(B)(ii) and explained its view thus:

> Section 506(b) permits a secured claim to include postpetition interest when the value of the collateral exceeds the amount of the allowed secured claim. This section allows an oversecured creditor to add interest that accumulates prior to confirmation to the secured claim awaiting distribution under the debtor's plan. This postpetition interest actually becomes part of the secured claim and may accrue until the effective date of the plan. Section 506(b) interest accrues from the date the petition is filed until the effective date of the plan. . . . Simply stated, section 506(b) interest becomes part of the allowed secured claim. It is the present value of this claim that must be paid under section 1 325(a)(5)(B)(ii).

In re Gladdin, 107 B.R. at 806 (citations omitted). Accordingly, the court rejected the argument that an oversecured creditor could receive § 506(b) interest after confirmation. The interplay of §§ 506(b) and 1325(a)(5)(B)(ii) was addressed in *In re DeMaggio* thus:

Appendix B

> Although § 506(b) and § 1325(a)(5)(B)(ii) both mandate a calculation of interest, there are different objectives underlying the actual selection of the interest rate under each section. As a result, the interest rate that will return the present value under the plan under § 1325(a)(5)(B)(ii) is not necessarily the same interest rate used to determine the allowed amount of the claim under § 506(b). While § 506(b) determines the exact amount of the claim as of the "effective date of the plan" § 1325(a)(5)(B)(ii) requires the payments made under the plan return the present value of that amount to the creditor. The two sections complement each other and together ensure the full payment of the value of the secured creditor's claim.

In re DeMaggio, 175 B.R. at 150 (citations omitted.)

Finally, no review of this topic would be complete without a mention of the Supreme Court's decision in *Rake v. Wade.* Courts have frequently cited *Rake* as authority for the proposition that under § 506(b), the oversecured creditor is entitled to postpetition interest on its claim until payment of the claim or the effective date of the plan. *See, e.g., In re Foettsch,* 167 B.R. at 560; *In re Harris,* 167 B.R. 813, 815 (Bankr. D.S.C. 1994); *De Sarno v. County of Allegheny,* 169 B.R. 329, 332 (Bankr. W.D. Pa. 1994); *In re Wilmsmeyer,* 171 B.R. 61, 63 (Bankr. E.D. Mo. 1994); *In re DeMaggio,* 175 B.R. at 147. In fact, the contrary was never argued as the respondent in *Rake* conceded, and his amicus the United States agreed, that because § 506(b) had the effect of allowing a claim to the creditor, the rights granted under § 506(b) were relevant only until confirmation of the plan. *See* 508 U.S. 464, 468. Nevertheless, the court,

citing 3 Collier on Bankruptcy § 506.05, p.506-43, and n. 5c (15th ed. 1993), noted that "[i]t is generally recognized that the interest allowed by § 506(b) will accrue until payment of the secured claim or until the effective date of the plan." *See id.* Accordingly, an oversecured creditor was entitled to preconfirmation interest on arrearages paid off under the mortgagor's plan pursuant to § 506(b) and postconfirmation interest on such arrearages pursuant to § 1325(a)(5)(B)(ii).[13]

The Second Circuit in *In re Valenti* concluded that the market rate of interest under § 1325(a)(5)(B)(ii) "should be fixed at the rate on a United States Treasury instrument with a maturity equivalent to the repayment schedule under the debtor's reorganization plan," 105 F.3d at 64, but that "[b]ecause the rate on a treasury bond is virtually risk-free, the § 1325(a)(5)(B)(ii) interest rate should also include a premium to reflect the risk to the creditor in receiving deferred payments under the reorganization plan." *Id.* The court below, citing *In re Dingley,* approved a 9% present value interest rate with respect to Key Bank's claim in the case of the Harkos and an 8.5% present value interest rate in the case of the Milhams. In *In re Dingley,* the court held that the appropriate present value interest rate was the rate on United States Treasury instruments with maturity that best matches the proposed payout term on the allowed secured claim with the addition of up to 3% risk premium. *See* 189 B.R. at 271. *In re Dingley* was cited with approval by the *Valenti* court and its holding is squarely within *In re Valenti.* Furthermore, Key Bank has not taken issue with the court below's assessment of the appropriate present value interest rate: its arguments are directed solely against the award

13. *Rake v. Wade* was effectively overruled by changes made by the Bankruptcy Reform Act of 1994 which added §§ 1123(d), 1222(d) and 1322 (e). Pub. L. No 103-394 (enacted on Oct. 22, 1994).

of present value interest as opposed to § 506(b) interest post-confirmation. Accordingly, the decision appealed from is hereby AFFIRMED.

Dated: July 30, 1997

BURTON R. LIFLAND, C.J. and
JOHN C. NINFO, II
Judges of the Second Circuit
Bankruptcy Appellate Panel

FOR THE PANEL

s/ Burton R. Lifland
Burton R. Lifland

APPENDIX C — DECISION BY THE BANKRUPTCY PANEL FOR THE SECOND CIRCUIT CONCURRING IN PART AND DISSENTING IN PART FILED JULY 31, 1997

BANKRUPTCY APPELLATE PANEL
FOR THE SECOND CIRCUIT

Case No. 96-50033

In re:

RONALD MILHAM and BENDETTA MILHAM

Debtors

KEY BANK OF NEW YORK

Creditor-Appellant

-vs-

RONALD MILHAM and BENDETTA MILHAM

Debtors-Appellees

Case No. 96-50031

In re:

MICHAEL PETER HARKO and MARGARET GRACE HARKO

Debtors

Appendix C

KEY BANK OF NEW YORK

Creditor-Appellant

-vs-

MICHAEL PETER HARKO and MARGARET GRACE HARKO

Debtors-Appellees

* * *

DECISION BY MICHAEL J. KAPLAN, U.S.B.J.
CONCURRING IN PART AND DISSENTING IN PART

The majority is transfixed by facially glossy jurisprudence that evolved principally in Chapter 11 cases and that truly applies only to undersecured claims. The notion of "present value" as it arises under Bankruptcy Code sections such as § 1325(a)(5) and 1129(b)(2)(i)(H) derives exclusively from consequences of deferral of payments, *i.e.*, a dollar tomorrow is worth less than a dollar today.[1] "Present value" is not implicated if I bargained for a dollar to be paid tomorrow, and if a plan promises precisely

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1. Unlike oversecured claims, "present value" is relevant as to undersecured claims that will not be paid in full under a plan. It is relevant because some of the dollars that originally were promised to be paid "tomorrow" are never going to be paid: The lender's claim is being "stripped-down" to the value of the vehicle and the unsecured deficiency will be paid less than in full. Discharge of the unpaid portion is the ultimate "deferral." It is therefore important to make certain that what the creditor will receive on account of the secured claim is not of less value than the replacement value today. *See Associates Commercial Corp. v. Rash*, No. 96-454, 1997 WL 321231 (U.S. Sup. Ct. June 16, 1997).

that — to pay a full dollar tomorrow. This is one of the differences between the notion of "present value" and the notion of "interest." Interest may be applicable even when "present value" is irrelevant. If a payment is not being deferred to a time beyond when it was due, there is no reason to consider "present value" in any sense, let alone the § 1325(a)(5)(B)(ii) sense. In more concrete terms, if the principal balance of an oversecured car loan will be paid off over more or less the same duration as the remaining duration of the original contract, and if it will be paid off by monthly payments that retire the debt over the approximate life of the remainder of the original contract duration, and at about the same risk level, then there is no need whatsoever to consider § 1325(a)(5)(B)(ii). Whatever rate of interest is ordered, it will be kept current on a monthly basis. The only issue remaining to be decided is what "profit" to award the oversecured creditor. In my view, that is where 11 U.S.C. §§ 506(b) and 1325(a)(1)[2] report front and center because § 1322(b)(2)[3] cannot be read as permitting a debtor to modify a creditor's § 506(b) statutory right out of existence.

It is well-settled that oversecured claims and undersecured claims are treated differently under the Code. Indeed, § 506(b) was only one aspect of Congress's plan, in 1978, to clear up

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2. Section 1325(a)(1) provides that, "the court shall confirm a plan if . . . the plan complies with the provisions of this chapter and with the other applicable provisions of this title. . ." 11 U.S.C. § 1325(a)(1). The first confirmation requirement, therefore, is that the plan comply with, among many other provisions, § 506(b).

3. Section 1322(b)(2) reads as follows: "[T]he [Chapter 13] plan may . . . modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims. . ." 11 U. S.C. § 1322(b)(2).

uncertainty surrounding treatment of secured claims in bankruptcy.[4] 11 U.S.C. § 506(b) commands "interest" (which is to say "profit"[5]) on oversecured debts.[6] In the case of *United Savings Assoc. v. Timbers of Inwood Forest Assoc.* (*In re Timbers of Inwood Forest Assoc.*), 484 U.S. 365 (1988), the Supreme Court, among other holdings, made it clear that there is to be no postpetition "interest" (which is to say postpetition "profit") on undersecured loans. In the case of *United States v. Ron Pair Enters.*, 489 U.S. 235 (1989), the Supreme Court stated that the clear language of § 506(b) is such as to apply to all oversecured claims, whether the lien is consensual or nonconsensual. The creditors here are oversecured, not undersecured and so § 506(b) clearly applies. (Indeed, the practice of permitting some secured claims to be paid "outside the plan" at contract rate has never been questioned, *e.g.*, payments on a mobile home.)

Further, 11 U.S.C. § 1325(a)(1) commands compliance with "all applicable provisions" of the Bankruptcy Code. Clearly, 11 U.S.C. § 506(b) is an "applicable provision." If the Chapter 13 Plans at issue do not defer the car payments past the dates

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4. *See, e.g.*, H.R. Rep. No. 95-595, at 180-81 (1977), *reprinted* in Appendix 2 Collier on Bankruptcy, pt. II (Lawrence P. King, ed., 15th ed. 1996).

5. Any effort to define contract interest as anything other than profit might be technically accurate, but pragmatically wasted. That profit is the key element of interest seems too obvious to belabor.

6. Although there may be true technical differences between oversecured "debts," as distinct from oversecured "creditors" or oversecured "claims," etc., I disagree with the courts and commentators who believe the distinctions to have relevance in the present context, as will be explained herein. Thus, this minority decision will use the terms interchangeably.

originally due, then 11 U.S.C. § 1325(a)(5)(B)(ii) is irrelevant and offers no shelter from § 506(b).

DISCUSSION

Rarely is a lien on personalty oversecured in a Chapter 13 case.[7] Consequently, nearly all of the gloss on § 1325(a)(5)(B)(ii) has derived from consideration of claims that are undersecured, rather than oversecured. To be sure, we are bound by *Rake v. Wade*, 508 U.S. 464 (1993), and *GMAC v. Valenti* (*In re Valenti*), 105 F.3d 55 (2d Cir. 1997). However, neither the Supreme Court in *Rake* nor the Second Circuit in *Valenti* was asked to address the operation of § 506(b). In *Rake* the Supreme Court merely reiterated, without analyzing, the parties' understanding of the operation of § 506(b) as to an oversecured creditor, and in *Valenti* § 506(b) was not mentioned at all because the creditor was undersecured.

The analysis offered by the majority is brilliant (as are some of the authorities upon which it is based) as applied to a completely different case. It would speak ably to: (1) undersecured claims; (2) oversecured claims that are being significantly stretched out to a point at which application of the contract rate would provide the lender with a windfall at the expense of unsecured creditors, relative to the possible yield to the creditor if the loan were fully repaid by the end of the note duration; or (3) a significant reduction in risk to the lender. But where, as here (perhaps[8]), the only effect

7. Some would argue that if there is equity in a car, the car salesperson goofed: With that large a downpayment, some have said that she should have talked the buyer into a more expensive car.

8. We do not have enough information here to determine whether and to what extent the oversecured creditors are being stretched out. Hence this opinion concurs in part and dissents in part.

of the plan is to reduce the oversecured creditors' profit, the high-sounding rationales of the majority's analysis lack substance. The majority has decided to accept a hand-me-down of the Emperor's new clothes. Following such rationales, the majority writes § 506(b) (an "interest" provision) out of the Code at the point that § 1325(a)(5)(B)(ii) (a "present value" provision) comes into play.

The majority claims to find its authority in 11 U.S.C. § 1322(b)(2). Although this writer agrees with the majority's observation that *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), does not require that a distinction be observed between contract rights and statutory rights for § 1322(b)(2) purposes it seems to this writer that such a distinction is so clearly commanded by a common sense interpretation of the statute that *Nobelman's* recitation only of contract rights in discussing rights modifiable under § 1322(b)(2) seems simply to state a truth premised in intuition. For Congress to grant a right to oversecured creditors that the debtor may unilaterally expunge is too bizarre a notion for the majority to rest upon. Yet it seeks to do just that.

By what authority did the court in the case of *In re Smith*, 178 B.R. 946 (Bankr. D.Vt. 1995), cited by the majority, conclude that bankruptcy courts "do not award profit, administration costs, risk, industry transactional costs, costs of collection, and all those other myriad elements that go into a contract rate"? No authority was cited for writing § 506(b) out of the Code in such a manner. Why did the court in that case fail to tell us whether the oversecured creditor was being stretched out or not? It is because that and other courts, which I greatly admire and respect, likely were not presented with the right argument. The key argument as to why § 506(b) should be applied as written is this — "Why not?" It is statute; it is plain; and it deals with "interest" while

§ 1325(a)(5)(B)(ii) deals with "present value," which is a different subject. This writer sees no sound basis upon which to write § 506(b) and § 1325(a)(1) out of the Code at the point of confirmation. The majority fails to address the fact that the first requirement for confirmation of a Chapter 13 plan is that the plan "compl[y] with the provisions of [the Bankruptcy Code]," 11 U.S.C. § 1325(a)(1), one of those provisions being § 506(b).

Courts addressing this issue have largely addressed policy reasons, as if the statute admitted of such an approach. In any event, let us address those on the merits. Firstly, there is the argument that the reasoning of this dissenting opinion would disrupt Chapters 11. Lawyers are used to negotiating a "fair and equitable" interest rate for payment of secured claims in that chapter. *See* 11 U. S.C. § 1129(b)(2)(i)(H). When negotiation fails, there is resort to the scholarship contained in an enormous body of cases and articles.[9] There seems to be concern that applying § 506(b) as written will disrupt the mystique that surrounds that process. This dissenting voice, it is submitted, adds only a wrinkle in the fabric of Chapter 11 debtor rehabilitation. The august body of scholarship remains completely applicable to undersecured claims. But, unless a completely oversecured creditor[10] otherwise agrees, such a creditor in Chapter 11 must be paid in full, and to pay that creditor at less than contract rate is, in Chapter 11 terms, to "impair" the creditor. An impaired, completely oversecured, nonconsenting creditor will always have certain preemptive rights over a Chapter 11 reorganization effort (and even over an orderly liquidation effort within Chapter 11).

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9. In 1995, the *Smith* case noted thirty-five articles on the subject. *See Smith*, 178 B.R. at 949 n.6.

10. "Completely oversecured" here means sufficiently oversecured that the limitation contained in § 506(b) will not be reached.

Therefore, the only practical effect that the present view would likely have if applied to a Chapter 11 case would be to extend the life of some plans or otherwise modestly enhance such a creditor's already-dominant power.[11]

Furthermore, the differences between Chapters 11 and 13 are far weightier than the similarities. For example, there is no "projected disposable income test" in Chapter 11; thus the dramatic impact of a higher interest rate on Chapter 13 debtors is not necessarily so dramatic in Chapter 11. Also, Chapter 11 plans have no time limit, and can deal with a long-term obligation by means of a long-term plan, whereas long-term obligations in a Chapter 13 case must be dealt with by "maintaining" payments outside the plan *at the contract rate of interest even as to undersecured claims*, unless the debtor can somehow afford to pay the long-term obligation off during the life of the Chapter 13 plan. Chapter 11 is a great deal more flexible than Chapter 13. Chapter 11 policy, in sum, should not control the present question, even if the statute were not so clear.

Next, it is often argued that to grant postpetition interest at the contract rate to an oversecured creditor would be "unfair" to unsecured creditors. So long as an unconscionable rate of interest is avoided (see discussion below) then I believe that the "fairness" issue was settled against unsecured creditors a very long time

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11. Specifically, the effect that an application of this dissent's analysis to Chapter 11 would have is to "ratchet-up" the rate to be paid to an oversecured creditor. Unquestionably, that is no small "item" in a big case. Millions of dollars might be implicated in a mega case, but that will typically mean a more extended plan, and not the difference between reorganizability and nonreorganizability, with very rare exceptions. In a liquidating case, the running of the interest "clock" always commands swiftness, and a higher rate will simply command greater swiftness.

ago. Surely in a Chapter 7 case, contract interest will be paid from the proceeds of sale of underencumbered collateral, no matter how much time lapsed between the petition date and the sale. If there is some reason to assess a § 506(c) charge against the secured creditor, that charge surely would be applied against a computation that permits interest to have accrued at the contract rate. Furthermore, we know that contract rate would be allowed outside bankruptcy. Truly, at least since the adoption of the Uniform Commercial Code by most states in the 1960's, the policy decision to benefit completely secured creditors at the expense of unsecured creditors has been unequivocal.

Moreover, the "fairness" issue was specifically addressed in the *Timbers of Inwood* case, wherein the United States Supreme Court recognized the pre-Code rule that "[i]t was considered unfair to allow an *under*secured creditor to recover interest from the estate's unencumbered assets before unsecured creditors had recovered any principal." *Timbers of Inwood*, 484 U.S. at 373 (emphasis added). The Court held that § 506(b) was enacted to codify that result; undersecured creditors are not to receive postpetition interest. However, the Court noted, § 506(b) "permits postpetition interest to be paid only out of the 'security cushion.' " *Id.* Clearly, the Supreme Court did not perceive that Congress saw anything "unfair" in awarding contract interest to an oversecured creditor, at unsecured creditors' expense, so long as it was paid out of an equity cushion.

Recently, the High Court observed, in the case of *Associates Commercial Corp. v. Rash*, No. 96-454, 1997 WL 321231 (U.S. Sup. Ct. June 16, 1997), that "from the creditor's perspective as well as the debtor's, surrender and retention are not equivalent acts." *Rash*, 1997 WL 32123 1, at *5. It seems to the present writer that when a debtor seeks relief under a rehabilitative chapter

of the Code, and elects to retain collateral, the result is not unlike a nonbankruptcy context in which the debtor *hides the vehicle from the lienor and thereby thwarts repossession and sale.* Can we doubt, in such context, that the unpaid balance continues to accrue interest at the contract rate until the creditor ultimately locates and obtains possession of the vehicle, and sells it?

As to grossly unfair rates of interest, this writer submits that *Ron Pair* (wherein it was held that interest is allowed even to noncontractual liens because the placement of punctuation marks in § 506(b) divorces the allowability of interest from the necessity of an agreement) stands for the proposition, by extension, that the interest that must be allowed to oversecured contractual liens is not necessarily the contract rate of interest. Rather, it seems that the rate of § 506(b) interest is committed to the sound discretion of courts, and the contract rate may or may not be applied. If the contract rate is grossly inequitable or would defeat the salutary purposes of the Code, then pursuant to *Ron Pair*, courts may select a lesser rate that grants an element of profit that is fair under the circumstances, perhaps to be set in reference to market rates of some pertinent sort.

In sum, then, in light of history, the Chapter 7 result, the § 506(c) result, the nonbankruptcy result, and the ability to temper unconscionability within the confines of § 506(b), the "fairness" rationale for the majority's decision is not worthy.

Finally, many commentators have focused on the ways in which the state law rights of oversecured creditors are similar to the state law rights of undersecured creditors, in determining that they should be treated alike after confirmation. For example, it is true that each is compelled to sell the vehicle in a commercially reasonable manner after repossession. The present writer believes

that the key regard in which the state law rights of the two are dissimilar has been ignored. Denying oversecured creditors the bargained-for rate not only "sticks" them with the equivalent of a money judgment (rather than cash) on the day of confirmation, but it treats the added value in the collateral as if it no longer exists. We all understand why it suffices to give an undersecured creditor only the present value of the car; the most that that creditor would get if it got the car back would be cash today equaling the value of the car. So the substitute of cash over time at present value under § 1325(a)(5)(B)(ii) works fine with undersecured claims. But an oversecured creditor, by definition, is a creditor who (were it not for the bankruptcy) would have the opportunity to bid in at sale, *and if no one else recognizes the true value of the vehicle* (not such a big "if," in point of fact, if (for example) the lender is itself a used car dealer who does not send the repo out to open auction), *the creditor could acquire title for the upset price, and resell the vehicle at a profit*. Hence, while the "most" that an undersecured creditor could obtain is a portion of the debt, the "most" that an oversecured creditor could obtain outside bankruptcy is the full amount of the debt, plus the excess value in the collateral. That is precisely what was bargained for by an oversecured creditor (particularly one who is a true purchase-money seller/lender), and what an undersecured creditor failed to obtain.

What has happened to that excess value in a Chapter 13 case? What happened to the value that the creditor bargained for as security for her profit on the loan? Under the majority's decision, that excess value has been converted to the debtor's benefit in the form of a $2400 state law exemption that the debtor would not enjoy outside Chapter 13 if the car only fetched the liened amount at a "commercially reasonable sale." Furthermore, under the majority's decision, any value over that liened amount

plus the exemption has been converted to the benefit of unsecured creditors by virtue of the Chapter 7 test.

In this writer's view the Code is not susceptible of such larcenous result. Particularly not when all the authority for that result is in derogation of § 506(b) and § 1325(a)(1) and is based only on either a misreading of *Rake v. Wade*, or on analyses that have facial appeal, but hold up to close scrutiny only in the context of undersecured claims. Indeed, in *Dewsnup v. Timm*, 502 U.S. 410 (1992), the Supreme Court stated that any postpetition increase in value of overencumbered collateral in a Chapter 7 case belongs to the lienor, not to the debtor or her creditors. To me, this hints that the same should be true of the excess value of underencumbered property in Chapter 13, until the debt is paid in full, profit and all.

Perhaps most importantly, we must not forget what Congress said when it overturned the ruling of *Rake v. Wade* in 1994, by enacting § 1322(e) and its Chapter 11 and 12 counterparts. The Supreme Court in *Rake v. Wade* had held that "present value" payments must be made even on the portion of prepetition mortgage arrears that were interest arrears despite the fact that state law prohibited payment of "interest on interest." Congress desired to make state law preeminent in that regard. When it did so, the pertinent Congressional Committee stated in the legislative history that the purpose of the amendment was to "limit the secured creditor *to the benefit of the initial bargain* with no court contrived windfall. It is the Committee's intention that a cure pursuant to a plan should operate to put the Debtor *in the same position as if the default had never occurred*." 140 Cong. Rec. H 10770 (daily ed. Oct. 4, 1994) (emphasis added).

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The specific language of § 1322(e) is this: "Notwithstanding subsection (b) (2) of this section and sections 506(b) and 1325(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law." 11 U.S.C. § 1322(e). The majority's explanation of how Congress could have intended prepetition arrears to be cured at the contract rate (unless that would constitute "interest on interest"[12] that would violate state law), but intended that unmatured future payments be paid at a rate that denies the creditor the "benefit of its initial bargain" is unpersuasive. Also unpersuasive is the majority's explanation of how its result is compatible with the fact that "maintenance" of payments outside the plan on long-term debts under § 1322(b)(5) must be at the contract rate of interest even if the creditor is undersecured rather than oversecured. Certainly, Congress could not have intended that § 506(b) and § 1325(a)(1) be written out of the Code at the point of confirmation by virtue of the mere fact that the remaining duration of the loan is less than the length of the debtor's proposed plan. (Long-term mobile home payments, for example, are routinely "maintained" outside the plan, at contract rate.) It is for these reasons that this writer believes that in general, the discretion of the court should be applied in favor of the contract rate.

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12. Again, as stated at the outset, a plan that promises payments that parallel the original note's amortization rate involves no deferral of payments and does not implicate § 1325(a)(5) at all. Hence, the majority's unsupported insistence that this writer's analysis results in "interest on unmatured interest" is specious.

Appendix C

CAVEAT

All of this being said, this minority decision dissents only in part because the Panel has not been told whether the interest rate is the only term that the Debtors seek to modify. It is important to know whether award of the contract rate will simply assure the oversecured creditor of the bargained-for profit, or whether it will provide to the creditor a true windfall at unsecured creditors expense.

Consider an illustration. I loaned you $10,000 to buy a $30,000 vehicle at 15% for three years. In the third year, when the vehicle is worth, say, $15,000 and you owe me perhaps $7,000,[13] you file Chapter 13 and propose to stretch the last year's payments out over five more years. If such were the case, an award of 15% might be a windfall to me, over and above the bargained-for profit. It would be a windfall if, as of the date of confirmation, markets had dropped to the point at which there were no way that I could obtain anything approaching a 15% yield on a five year investment of monies equal to what I would receive on the remaining payments on the car loan according to the original terms, if I were to invest each of those payments.

Were this a two-party dispute only, this writer would have no difficulty imposing the 15% rate on the debtor who elects to stretch out the remainder of the payments over the lender's objection. Indeed a failure to do so probably would invite abuse of Chapter 13. I would not, however, impose a windfall rate at the expense of the debtor's other creditors.[14] If, in fact, market

13. I have not done the amortization computations.

14. Often there would be no loss to other creditors. The plan simply would be extended, not to exceed five years.

rates of interest had dropped substantially, it is at the point that applying the contract rate to a stretch-out would yield a windfall, that I would pay heed to the majority's decision and the authorities upon which it claims to be based.

I am not suggesting that under those circumstances the contract rate should apply until a specified date during the life of the plan, and then a different rate thereafter. Rather, a stretch-out, by definition, involves a deferral of payments, and reference to § 1325(a)(5)(B)(ii) is proper. As of the date of confirmation, the present value of what the oversecured creditor will receive under the plan must not be less than the present value of what the creditor was to receive over the balance of the original contract.[15] That, in this context, is what is meant by § 506(b), § 1325(a)(1), and § 1325(a)(5)(B)(ii) when read in *pari materia*. If a fair rate of interest (a fair rate of profit) is fully paid on a monthly basis in a Chapter 13 plan, the argument that this analysis requires payment of interest on unmatured interest is entirely baseless.

Where there is, in fact, deferment the simplest way to address the complex functions invoked by this writer's analysis is to negotiate and settle them. Indeed that is the way that nearly all cases that involve the present fact pattern are resolved in all three of the rehabilitative chapters — Chapters 11, 12 and 13. (Perhaps in Chapter 9 as well. This writer has no experience with that Chapter.)

The rules of administrative convenience adopted by many courts for dealing with the present value issue as to undersecured claims are wholly appropriate, as affirmed by the *Valenti* decision, since the value of the undersecured claim is easy to measure; it is

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15. Some will take issue with this formulation. *See supra* note 6.

the value of the vehicle. As to oversecured claims, the value of the vehicle is not relevant. We must measure the value of what the creditor was to receive under the original contract. So rules of administrative convenience fail us. The difficulty in reaching the correct result as to oversecured claims where a substantial modification is sought other than merely as to interest rate, is precisely the reason that any dispute should be negotiated to settlement. The complexity, expenses, and uncertainty of litigating the "present value" of what a particular stretched-out oversecured creditor will receive under a plan, as compared to the present value of what that creditor was to receive over the balance of the original term of that contract, should cause one to shy away from the effort, and cause one to seek a settlement instead. (Over a mere three to five year period, the "swing" in possible rates would likely be offset by the cost of the proof.)

CONCLUSION

As stated at the outset of this minority opinion, if the principal balance of an oversecured car loan will be paid off over more or less the same duration as the remaining contract duration, and if it will be paid off by monthly payments that keep the interest current and retire the debt over the life of the remaining duration of the original contract, and if it will be paid at about the same risk, then no reference to § 1325(a)(5)(B)(ii) is necessary because there are no "deferred payments." Section 506(b) should be viewed as requiring that the creditor be left unimpaired unless it agrees to the impairment or unless the contract rate is unconscionable, in which latter event it may be mitigated pursuant to *Ron Pair*. To fail in this is to appropriate to others the excess value that the secured creditor bargained for and that would surely be available to secure the creditor's profit if the debtor simply hid the collateral for three to five years in a storage shed rather than "hiding" it here, under the shelter of the court.

For all of the above reasons, I would remand for further proceedings. If the plan provisions for payment of the oversecured creditor in these two cases are not very different from the original loan terms, I would direct an award of the contract rate. If there are other significant differences (stretch out, changed use, etc.) *and* if contract rate would result in a windfall at the expense of someone other than the Debtors, I would direct that the rate be tempered by the bankruptcy court's discretion, and only a "fair profit be reflected in the awarded § 506(b) rate. On the other hand, if there are other significant differences and the contract rate would leave the creditor with *less* (at present value) than what the present value rate would yield to that creditor, then something closer to what some commentators have referred to as a "forced loan" rate[16] should be negotiated, under § 1325(a)(5)(B)(ii), even though higher than contract rate.

Dated: Buffalo, New York
July 29, 1997

s/ Michael J. Kaplan
Michael J. Kaplan, U.S.B.J.

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16. Although the notion of a "forced loan" rate has been criticized because of the absence of a lender market, the *Valenti* decision permits the court to make an adjustment for "risk" that might, for example, foretell approval of an approach that adds a risk factor to market rate to produce a forced loan rate.

APPENDIX D — TRANSCRIPT OF HEARING BEFORE THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF NEW YORK DATED AUGUST 22, 1996

Case No. 96-11076, 96-12157
96-12543

In re:

HARKO, MILHAM, PELLETIER,

Debtor,

TRANSCRIPT OF HEARING
BEFORE HONORABLE ROBERT E. LITTLEFIELD, JR.
UNITED STATES BANKRUPTCY JUDGE

* * *

THE CLERK: The next matters on the calendar will be called together, and this is going to be the matter of Eric and Stephanie Pelletier, case number 96-12543. Ronald and Benedette Milham, case number 92-12 — case number 96-12157. And the case of Michael and Margaret Harko, case number 96-11076. And these are all objections to confirmation by Key Bank, will the parties note their appearances for the record.

MS. DAVIS: Diane Davis on behalf of the Chapter 13 Trustee.

MR. GOODMAN: Martin Goodman, attorney for Ronald and Benedette Milham and for the Pelletiers.

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MS. TAMBASCO: Annette Tambasco on behalf of Key Bank.

MR. MEOLA: Rudolph Meola, attorney for Amicus curiae.

THE COURT: Mr. Goodman, you represent which of these debtors?

MR. GOODMAN: I represent the Milhams and the Pelletiers.

THE COURT: Who represents the Harkos, Ms. Wolf?

MR. GOODMAN: Jeff—

THE CLERK: Gerald Bartman is listed.

THE COURT: Regarding the objection to the bank, the following constitutes my findings of fact and conclusions of law, pursuant to bankruptcy rule 705(2)

In each of these cases Key Bank the over secured claim holder has objected to confirmation of debtors plans. Key Bank asserts that by virtue of being over secured, it is entitled to post petition interest on its over secured claim at the rate set forth in the pre-petition loan document.

Common to these cases, is the bank's objection to one, valuation of the collateral and two, the rate of interest paid post confirmation on its over secured claim.

Also on each case the collateral at issue is the debtor's car. In Milham the debtor proposes to pay the bank's over secured claim at 8.5 percent. The present value rate required under code

section 1325(a)(5)(B)(2). See *In Re: Dingli* 189 BR 264 Bankruptcy Northern District of New York 1996. Rather than at the rate set forth in the pre-petition contract.

In Harko, the debtor has failed to propose paying any interest post confirmation on the bank's over secured claim. It appears in each case that the debtor has proposed to value the collateral consistently below the average NADA value.

Unless the respective debtors are able to affirmatively show a factual basis for their below average valuations, see local bankruptcy rule 312(b), the plans as proposed shall not be confirmed.

In Harko, the debtor has failed to propose payment of any post confirmation interest on the bank's secured claim. It is clear that the debtor's plan cannot be confirmed, over the bank's objection. The bank must receive the present value of its over secured claim, post confirmation.

What is troubling, although the bank has not raised this objection, is the taint of bad faith created by the debtor's apparent — apparently purposeful under valuation of the collateral, and the failure to propose the payment of a present value interest rate on the bank's secured claim.

It is not clear whether the source of this is the debtors or their attorney or both. But this sort of practice appears without legal and factual support. A debtor trying to pull a fast one, while at the same time, requesting the Court to make a finding under code section 1325(A)(3) that the plan was proposed in good faith puts the debtor's entire case on the thinnest of ice, and exposes the debtor and their attorney to possible sanctions under rule 9011.

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Fortunately the Harkos have resolved the valuation issue with the bank and the Court need not further consider that portion of the bank's objection.

The remaining question is whether the debtors are required to pay a contract rate of interest pursuant to code section 506(b), post confirmation on the bank's over secured claims.

The parties have submitted legal briefs limited to this issue. The Supreme Court in *Rake v. Wade* 113 Supreme Court 2187, 1993. Noted that it is generally recognized that the interest allowed by 506(b) will accrue until payment of the secured claim, or until the effective date of the plan.

A leading treatise cited with approval by the *Rake* Court also limits interest under code 506(b) to the pre-confirmation period. See three king, Collier on Bankruptcy, 506.05 at 506-47, 15th Edition, 1996.

The *Rake* Court concluded that post confirmation, the over secured claim holder was "entitled to the present value" of its over secured claim pursuant to code section 1325(a)(5). See also *Dean Poloic*, entitled to — entitlement to interest under the bankruptcy code, 12 Bankruptcy Development Journal, 149, 1995.

Stating in fact that code 506(b) governs the accrual — accrual of interest after the filing of a petition, but prior to the confirmation, or effective date of the plan.

Lower courts have generally followed the Supreme Court, and concluded that the interest rate paid on a secured claim post confirmation, in a Chapter 13 case, shall reflect present value as required under code section 1325(a)(5)(B)(2), see for example,

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In Re DeMaggio 175 BR 144, Bankruptcy Northern — District of North — New Hampshire 1994, and *In Re: Fortex* 167 BR 555, 560 Bankruptcy in the District of New Hampshire 1994. I'm sorry, Bankruptcy Northern Dakota, 1994.

Section 1322(b)(2) permits a debtor through the plan, to modify the rights of holders of secured claims. That provision of the code is not ambiguous. There is no exception for over secured claims. If Congress had intended to accept over secured claims from the reach of code section 1322(b)(2) it could have easily done so, as it did with home mortgages.

Congress did not choose to include such an exemption, and an intent to the contrary cannot be fairly implied from code 1322(b)(2) or any other section under Chapter 13 for that matter.

Section 1325(a)(5)(B) provides that with respect to an allowed secured claim, a plan may be confirmed if the holder of the secured claim receives post confirmation the present value of its secured claim.

Again, at the point of confirmation the code does not distinguish between over secured, and under secured claims. Claims are either secured, or unsecured.

Although Key Bank seeks this Court to award it a post confirmation right to interest under code 506(b) Congress has not seen fit to include such a right in the code. Therefore the bank's problem would be more appropriately addressed at the legislative level.

Based upon the foregoing, this Court concludes that a Chapter 13 case, the interest rate applicable post confirmation

on an over secured claim, is that which provides the "present value" of the allowed secured claim. *See In Re: Dingli* 189 BR 264, Bankruptcy Northern District of New York 1996.

The over secured claim holder is entitled to interest the pre-petition contract rate under code 506(b) only up to the effective date of the Chapter 13 plan. Based on the foregoing the bank's objection is overruled, and the Trustee shall submit a confirmation orders in accordance herewith over the bank of — over the bank's objection, with notice of entry and even though, not specifically addressed, this decision will apply to the — which decision Ms. Wolf?

THE CLERK: Pelletier.

THE COURT: Pelletier in that the over secured creditor is not entitled to the contract rate of interest. Questions?

MR. GOODMAN: No —

COURT: Ms. Davis, you'll submit the appropriate order.

MS. DAVIS: Yes, Your Honor.

COURT: Over the objection of — of counsel. Thank you very much.

TAMBASCO: Your Honor.

THE COURT: Yes.

TAMBASCO: I just want to say one thing, in regard to the plaintiff's attorney in the Harko case.

THE COURT: Yes.

MS. TAMBASCO: I know he was kind of new when he was doing that, and I don't — I don't think he intended to leave it out, I'm — the interest rate out on purpose, and in fact we had talked about what the interest rate would be subsequent hereto.

THE COURT: My — my point is simply without making is — is just that — let the word go forth. And that good faith will be found or not found appropriately. Thank you.

MS. TAMBASCO: Thank you Your Honor. (Court adjourned)

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